



**LONDON
ECONOMICS**

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July 29th, 2020

Dear EUT Committee Members,

At the EUT Committee meeting last Friday, July 24th, 2020, Rep. Seth Berry introduced Dr. Richard Silkman's analysis, a peer review of the February 2020 report prepared by my firm, London Economics International LLC ("LEI"), which evaluated the impacts and costs/benefits associated with the creation of the Maine Power Delivery Authority pursuant to LD 1646.

We appreciate Dr. Silkman's time and effort to review our report and the financial analysis we completed to support our findings. However, we strongly disagree with Dr. Silkman's conclusions that there are significant additional savings for ratepayers from the cash balance that is built up over time under MPDA ownership. We also disagree with two other additional benefits that Dr. Silkman estimates, due to changes in future operating costs and modification of the rate of return charged through in New England's regional (formulaic) transmission tariff. Although we have not had the opportunity to review Dr. Silkman's calculations, based on the description he provided in his presentation, we believe that he is inappropriately adjusting LEI's financial analysis of ratepayer impacts, which leads to an *overstatement of projected benefits* to ratepayers under MPDA ownership.

Issue #1: Cash balances are not equivalent to additional "equity" and cannot be refunded or credited back to ratepayers without causing an increase in the financing costs for MPDA, which will harm ratepayers in the longer term.

Dr. Silkman is correct in pointing out that LEI's financial model includes a cash balance that builds up over time and reaches a forecast value of over \$5 billion by 2053 under the MPDA ownership scenario. However, this is not equal to "equity",¹ nor can this cash balance be refunded to ratepayers to create a net benefit. This cash balance must remain

¹ The cash balance is an asset on the balance sheet for MPDA (assets are on the left-hand side of the balance sheet). On the other hand, equity would be part of the capitalization and liabilities (right hand side of the balance sheet). Therefore, in LEI's financial model, "equity" would actually be represented by patronage capital. Patronage capital would have to increase if the cash balances were reduced, in order to ensure that MPDA could continue to borrow funds to finance its operations and investments. Patronage capital is acquired through retained earnings (or contributions from ratepayers). All cooperatives and municipally-owned utilities must carry some level of patronage capital and maintain adequate cash balances to ensure access to capital markets.

on balance sheet to continuously support the credit metrics of the MPDA and to ensure that it can borrow funds at favorable rates. If the cash balance is eliminated, for example refunded to ratepayers, then MPDA's liquidity would decline and MPDA may have to take on debt at higher interest rates. Moreover, the MPDA may have to raise future rates in order to re-establish the target levels of capitalization in order to continue to borrow. Crediting the cash balance to ratepayers, in order to create bigger rate savings, is essentially an act of borrowing against future revenues. For example, if MPDA were to refund all (or some) of the cash balance to ratepayers in the first ten years of MPDA's operation, this action would lead to lower net payments for current ratepayers but require rate increases in the future, thereby reducing the benefit of MPDA ownership for future ratepayers. This is a tradeoff that MPDA's Board can decide to take, but it should not be viewed as a "win-win" for all ratepayers. In some ways, the act of refunding the cash balance is akin to taking on a second mortgage. A second mortgage may provide some immediate cash to the homeowner, but it also increases the homeowner's debt burden and that would negatively impact the homeowner's disposable income in the future.

Issue #2: Estimated ratepayer benefits that are geared off "gaming" FERC-regulated rules on transmission rate design are very risky and should not be relied upon.

Dr. Silkman adjusted the return on equity ("ROE") that MPDA would charge through in ISO-NE regional transmission rates and that led to lower rates for Maine ratepayers in LEI's financial model. We don't disagree with the mathematical properties of such an outcome, but the practical and legal aspects of such an outcome are controversial. First, transmission owners across New England would have to agree to depart from a multi-decade precedent set in the region for rate design. Second, regulators from other New England states (and the respective transmission owners) would have to willingly allow their local customers to pay more for regional transmission service. It would clear that by charging through a higher ROE, the MPDA is employing cross-subsidization – where the higher transmission rates (collected from out-of-state customers) would defray (and reduce) other costs of the MPDA. On that basis, we do not believe it is reasonable to assume that other New England stakeholders (and FERC) would agree to allow MPDA to set transmission rates in such a way, and therefore these estimated benefits for Maine ratepayers are not realistic.

Issue #3: It is premature to forecast that future operational expenditures would be smaller under MPDA ownership.

We agree with Dr. Silkman's initial observation that there are alternative trajectories for future operating costs. Regardless, the selected rate of growth in operating costs should not result in material difference in future ratepayer benefits, if the future trajectory of operating costs is similarly applied to both the continued IOU-ownership scenario and the MPDA-ownership scenario in the financial model. Therefore, Dr. Silkman must be making an assumption that operational costs will grow at different rates if MPDA comes into existence or if the IOUs continue to operate the system. In other words, Dr. Silkman is presuming that relative operational efficiencies would improve under MPDA ownership. In LEI's report, we cautioned against making such presumptions without additional due diligence. An in-depth review of potential contracts with the operator (and determination of the risks that the operator would be asked to take, as well as the incentives/compensation

that would be needed to motivate the operator) will be critical for assessing whether MPDA ownership could lead to more efficient operations. We understand that the amended LD 1646 bill is contemplating such additional due diligence. We applaud the Committee in taking the appropriate next steps before coming to a definitive conclusion on ratepayer savings.

In summary, LEI's estimate of ratepayer impacts from implementation of LD 1646 did not omit or overlook any substantive source of benefit for Maine ratepayers. We continue to believe that there are important tradeoffs to consider when evaluating the costs and benefits of the MPDA. Electric ratepayers many years from today may reap the benefits of lower rates due to the financing advantage of future investment by a tax-exempt entity. However, in the near term, electric ratepayers may see a rate increase due to the incremental costs of starting up the MPDA. In other words, LD 1646 may create intergenerational trade-offs, where current ratepayers may perceive the value of LD 1646 differently from future ratepayers.

Thank you for your time in reading through this letter. Please feel free to reach out to me with any questions at julia@londoneconomics.com.

Sincerely,

A handwritten signature in black ink, appearing to read "Julia Frayer", with a long, sweeping horizontal flourish extending to the right.

Julia Frayer
Managing Director
London Economics International LLC

cc: Phil Bartlett, Chairman of the Maine Public Utility Commission
Dan Burgess, Maine Governor's Energy Office